

**REASONABLE RESTRICTIONS: THE SUPREME
COURT OF CANADA'S NARROW APPROACH TO
RESTRICTIVE COVENANTS**

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INTRODUCTION

Employers involved in businesses in which certain employees play a fundamental role in fostering the employer's trade connections with customers, suppliers and clients, and have broad access to the employer's confidential information and trade secrets, often seek to protect themselves from the potential business losses that could result when such employees leave.

Many employers will include restrictive covenants in employees' employment contracts in order to protect these interests. An employer may, for example, stipulate that upon the cessation of employment, an employee may not be involved in a competing business for a certain amount of time, within a particular geographic location.

The two principal types of restrictive covenants are: 1) non-competition clauses, which limit a departing employee's ability to start a competing business, or accept a new position with a competitor of the former employer; and 2) non-solicitation clauses, which prohibit the departing employee from soliciting the customers of his or her previous employer.

The general rule that courts will apply in respect of restrictive covenants is that they are contrary to public policy and, therefore, are generally found to be void. This is because most restrictive covenants are considered to be restraints of trade, which interfere with employees' liberty of action. When analysing restrictive covenants, courts recognize the tension between freedom of contract, on the one hand, and public policy considerations against restraining trade, on the other. At the same time, the courts have taken notice of the imbalance of power that exists between employers and employees, whereby employees are often considered to be in a disadvantaged position in comparison to employers.

As a result of these considerations, the onus is firmly placed on the employer, as the party seeking the benefit of the restrictive covenant, to justify it as valid. Only restrictive covenants that: 1) protect a legitimate proprietary interest; 2) are reasonable; and 3) are not contrary to the public interest, will overcome the general presumption that they are void.

When determining whether a restrictive covenant is reasonable, a court will generally focus on whether the duration and the geographic scope of the covenant are reasonable. Accordingly, an employee seeking to

escape the application of a restrictive covenant will often attack it on that basis. If a court finds the duration or the geographic scope of the restrictive covenant to be overly broad, the court will strike it down as unreasonable and the employer will lose its protection.

SHAFRON v. KRG INSURANCE BROKERS (WESTERN) INC.

In *Shafron v. KRG Insurance Brokers (Western) Inc.* (2009), 301 D.L.R. (4th) 522 (S.C.C.) (“*Shafron*”), the focus was on the geographic scope of a non-competition clause. However, the issue was not whether the geographic scope was overly broad, as is normally the case. Rather, the question to be determined was whether the geographic description itself was ambiguous.

Background

KRG Insurance Brokers (Western) Inc. (“KRG”) entered into a series of employment contracts with an insurance salesman, which included a non-competition clause in which KRG sought to restrain the insurance salesman from competing with KRG within the “Metropolitan City of Vancouver” upon the cessation of his employment.

The Trial Judge refused to enforce the non-competition clause because it was found that the term “Metropolitan City of Vancouver” was not a proper entity and therefore was not clear, certain or reasonable.

The British Columbia Court of Appeal, however, found that by using the term “Metropolitan City of Vancouver,” the parties meant the “City of Vancouver, the University of British Columbia endowment lands and the Cities of Richmond and Burnaby.” Consequently, the British Columbia Court of Appeal found that the non-competition clause was enforceable.

The Supreme Court of Canada’s Decision

After noting that a restrictive covenant would only be valid if it is found to be reasonable, the Supreme Court of Canada (the “SCC”) stated that an ambiguous restrictive covenant would generally be unenforceable because the party seeking to enforce it would be unable to demonstrate reasonableness in the face of the ambiguity. Therefore, an ambiguous restrictive covenant is by definition unreasonable. Only if the ambiguity can be resolved, is it possible to determine whether the restrictive covenant is otherwise reasonable.

The issue to be determined by the SCC in *Shafron* was whether the doctrine of severance could be applied to “fix” the ambiguous term “Metropolitan City of Vancouver.”

The SCC stated that there were two types of severance that have been applied by the courts to remove illegal features of a contract, in order to bring the contract into conformity with the law:

1. “Notional” severance, which involves reading a contractual provision in a way that would make it legal and enforceable; and
2. “Blue-pencil” severance, which involves removing the illegal portion of a contractual provision without affecting the meaning of the remaining portions.

The SCC, however, cautioned that the doctrine of severance should only be used in limited circumstances.

The SCC emphasized that the purpose of the doctrine of severance was to give effect to the intention of the parties when they entered into the contract. Significantly, the SCC stated that the courts will be restrained in their application of the doctrine of severance because of the rights of parties to choose the words that determine their obligations and rights.

Notional Severance

The SCC found that notional severance should not be applied to the construction of restrictive covenants in employment contracts for two reasons.

First, the SCC reviewed a decision (decided outside of the employment law context) in which notional severance was appropriately applied to a contract that was illegal because it included an interest rate that was greater than the statutory maximum. In that decision, the court “read down” the interest rate to the statutory maximum of 60% because it was clear what needed to be done in order to make the contract legal, and the court inferred that the parties’ original common intention was to charge and pay the highest interest rate. The SCC stated that, in that decision, the existence of the statutory maximum interest rate created a “bright line test,” pursuant to which the contract could be rendered legal objectively. In contrast, the SCC stated that there was not a similar “bright line test” that could be applied in all cases in order to make an unreasonable restrictive covenant legal. Therefore, applying notional severance would simply

amount to the court rewriting the covenant in a manner that it subjectively considered reasonable in each individual case. The SCC stated that such an approach would create uncertainty as to what may be found to be reasonable in any specific case.

Second, applying the doctrine of notional severance would invite employers to impose unreasonable restrictive covenants on employees, and the only sanction would be that if a particular covenant were found to be unreasonable, the court would still enforce it to the extent of what might validly have been agreed to by the parties. The SCC made the following comments at p. 534:

Not only would the use of notional severance change the terms of the covenant from the parties' initial agreement to what the court thinks they should have agreed to, it would also change the risks assumed by the parties. The restrictive covenant is sought by the employer. The obligation is on the employee. Having regard to the generally accepted imbalance of power between employers and employees, to introduce the doctrine of notional severance to read down an unreasonable restrictive covenant to what is reasonable provides no inducement to an employer to ensure the reasonableness of the covenant and inappropriately increases the risk that the employee will be forced to abide by an unreasonable covenant.

The SCC concluded that the Court of Appeal erred when it essentially rewrote the geographic scope of the non-competition clause, and that it was not permitted to rely on the doctrine of notional severance, as it purported to do. The SCC emphasized that notional severance does not permit a court to rewrite a restrictive covenant in an employment contract in order to reflect its own view of what the parties' consensus might have been or what the court thinks is reasonable in the circumstances.

Blue-Pencil Severance

The SCC found that, in the context of restrictive covenants, blue-pencil severance could only be resorted to sparingly and only in cases where the part being removed was clearly severable, trivial and not part of the “main purport” of the restrictive covenant.

In response to KRG’s assertion that the SCC should apply blue-pencil severance to remove the word “Metropolitan,” the SCC stated that since there was no evidence that the parties would have “unquestionably” agreed to remove the word “Metropolitan” from the ambiguous geographic description, without varying any other term of the contract, or otherwise changing the bargain, blue-pencil severance could not be applied under the circumstances.

Rectification

The SCC also rejected KRG’s argument that the doctrine of rectification be applied in order to clarify the mistaken geographic description. The doctrine of rectification involves altering the written words of a contract so that they reflect the actual agreement between the parties.

The SCC noted that in order to apply the doctrine of rectification, it was necessary to show that the parties were in complete agreement on the terms of their contract, but wrote them down erroneously.

The SCC stated that there was nothing to indicate what the parties intended by the use of the term “Metropolitan” when they entered into the contract, so as to justify applying the doctrine of rectification. Similarly, there was nothing to indicate that they agreed on an area and then mistakenly wrote down “Metropolitan.” The SCC concluded that without pointing to a prior agreement that was departed from when the parties put the contract into writing, rectification was not available.

CONCLUSION

The *Shafron* decision reinforces the importance of careful drafting and precise language when developing restrictive covenants. In light of the importance that courts place on employees’ liberty of action, and due to the imbalance of power that is found to exist between employers and employees, courts will have little sympathy for employers who seek to rely on ambiguous terms or terms that are potentially more restrictive than necessary.

This decision confirms that if a restrictive covenant is in any way ambiguous or unreasonable, the courts will not rewrite the parties' bargain in order to bring it into compliance, and the courts are unlikely to strike out the offending language. The result will be that the employer will lose the entire benefit of the covenant.